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IN THE

# Supreme Court of the United States

OCTOBER TERM, 1941.

No. 204

NETTIE MEYER, ANNA JACOBSON, JACOB MEYERHOFF, JOSEPH MEYERHOFF, JULIUS MEYERHOFF, RAY MANN AND JOHN J. PANKIN,

*Petitioners,*

*vs.*

KENMORE-GRANVILLE HOTEL COMPANY, SAMUEL J. T. STRAUS, MELVIN L. STRAUS, M. A. ROSENTHAL ET AL.,

*Respondents.*

**PETITION FOR WRIT OF CERTIORARI TO THE APPELLATE COURT OF ILLINOIS, FIRST DISTRICT, AND BRIEF IN SUPPORT THEREOF.**

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*Respondents.*

---

## PETITION FOR WRIT OF CERTIORARI TO THE APPELLATE COURT OF ILLINOIS, FIRST DISTRICT, AND BRIEF IN SUPPORT THEREOF.

---

*To the Honorable the Chief Justice and Associate Justices of the United States:*

Petitioners, Nettie Meyer, Anna Jacobson, Jacob Meyerhoff, Joseph Meyerhoff, Julius Meyerhoff, Ray Mann and John J. Pankin, Pray the issuance of a Writ of Certiorari to review the judgment of the Appellate Court of Illinois for the First District whose judgment was made final by the denial of leave to appeal by the Supreme Court of Illinois on April 10, 1941.

## Statement of the Matter Involved.

Petitioners are a group of investors who purchased Gold Bonds from S. W. Straus & Co. (hereafter referred to as "Straus") secured by two trust deeds, one on the Sovereign Hotel, and the other on the Annex, for $1,000,000 each. Petitioners' action for accounting against the two trustees, who were in possession of the mortgaged premises after default for several years, and against the Protective Committees who betrayed their trust duties, was held to be barred by a defense of *res adjudicata* based on proceedings in the District Court under section 77B.

**Material facts** "Straus" floated two bond issues for $1,000,000 each, one on the Sovereign Hotel, in 1919, and another on the Annex, in 1922. The officers of "Straus", Samuel J. T. Straus, President, and Melvin L. Straus, Vice-President, were the trustees of the "Sovereign" and "Annex" respectively. The Annex Bond Issue contained a personal guarantee of the principal shareholder (R. 38). Default was made in the first years' taxes after the construction of the Annex. Both properties were sold for the non-payment of the 1923 taxes (R. 38). Defaults in principal and interest followed and the two trustees entered into possession on May 8, 1925 and remained in possession until 1934 (R. 39). The petitioners were not informed of these facts until January 29, 1931 when they were urged to deposit their bonds with Protective Committees headed by Straus officials (R. 35). The two trustees deposited the net income with "Straus", which income was used to reimburse it for principal and interest advanced to the unaware bondholders. Many of the deposits were made as late as three months after maturity (R. 40, 41). During that period "Straus" obtained title to the mortgaged premises via a junior foreclosure, subject to the continuing lien of the bond issue. It obtained a

Master's Certificate on December 19, 1929 in the name of Sidney H. Kahn, one of its vice-presidents, who headed one of the Protective Committees. The trustee, Samuel J. T. Straus, headed the other Protective Committee (R. 35). After thus acquiring the properties, "Straus" solicited the deposit of the bonds with its Committees. These Committees adopted a Plan of Reorganization which called for the formation of a corporation to acquire the properties at the foreclosure sale, to exchange the bonds for common stock, giving 10% to "Straus" and 90% to the investors under a Voting Trust, which vested control of the property in "Straus". This plan, which was prevented by petitioners' suit, was carried out in the Federal Court under Section 77B with some modifications. As a result of the reorganization, petitioners' bonds were exchanged for stock whose value is eight cents on the dollar (R. 27, 28). The action of the petitioners against the trustees and the committee members for accounting, malfeasance and misfeasance was barred by the defense of *res adjudicata* based upon the 77B proceedings, and petitioners will lose 92% of their investment.

**History of the Litigation Which Barred This Proceeding** Nettie Meyer, one of the petitioners, was the only plaintiff in the suit commenced by her on February 8, 1935 seeking an accounting from the trustees, and the prevention of the fraudulent reorganization plan by the Straus Committees. She served notice on March 12, 1935 that she would appear in court on March 13, 1935 and ask for the appointment of a receiver and the restraining order. On that day the respondents filed a consent to the approval of an involuntary petition for corporate reorganization under Section 77B,* obtained the approval of the petition and restrained the proceed-

* This consent was given by the corporation which Straus organized and which acquired title from Kahn in 1932 (R. 37) but which never functioned as the property was either in possession of the Trustees or in possession of a tax receiver.

ings in the State Court (R. 48). Nettie Meyer filed her petition in 77B proceedings seeking to set aside the orders for lack of good faith and jurisdiction,** and the respondents moved to strike her petition (R. 48, 49). The District Court rendered on opinion on March 20, 1937 to the effect that the restraining order will not prevent the action for accounting, malfeasance and misfeasance provided it will not interfere with the 77B proceeding (R. 46). It denied the motion to vacate the orders but refused to strike the petition and ordered that due notice be given to counsel for Nettie Meyer on all further proceedings. Nettie Meyer appealed from this under 24a, and on May 21, 1935 the Seventh Circuit dismissed the appeal on jurisdictional grounds (77 Fed. (2d) 1004). The other petitioners, who were later joined as parties plaintiffs to the suit of Nettie Meyer, filed objections and suggested modifications to the Plan. On February 27, 1935 the District Court sustained some of the objections and approved the Plan as modified, including that part of the Plan which gave "Straus" a 10% interest in the reorganized property (R. 50, 51). Leave to appeal was denied by the Seventh Circuit on June 25, 1935, and the appeal taken under 24a was dismissed on jurisdictional grounds 78 Fed. (2d) (1118). This court allowed certiorari on the dismissal of the two appeals (296 U. S. 565) and finally decided that the appeals were properly dismissed on jurisdictional grounds (*Meyer* v. *Kenmore-Granville Hotel Co.*, 297 U. S. 160). On November 23, 1936 the District Court entered an order, without notice to petitioners' counsel, dismissing the petition of Nettie Meyer and ordering a release of the two trust deeds. Petitioners filed a petition on December 4, 1936 seeking to vacate the order (R. 52). This matter was referred to referee upon the answer to the petition. On February 25, 1937 the District Court approved the report of the referee and dismissed the petition. Within the term time it entered

** The attack was based on the facts stated in the above note.

a final decree discharging the Debtor. Petitioners applied for leave to appeal under 24b which was denied (90 Fed. (2d) 151). They prosecuted an appeal under 24a from both orders, which appeal was dismissed on the ground that petitioners were dismissed out as interveners and had no right to appeal (92 Fed. (2d) 778). This court denied certiorari on January 17, 1938 (302 U. S. 767). The respondents urged on the appeal in the Seventh Circuit (R. 45) that the adjudication in the 77B proceeding could not be pleaded in bar of petitioners' action in the State Court for accounting and for malfeasance and misfeasance (R. 45, 47).

**The Proceedings For the Accounting.** After the denial of certiorari by this court making final the order discharging the Debtor and completing the reorganization, petitioners filed an Amendment to their Complaint (R. 11-13) setting forth the proceedings in the Federal Court which culminated in the approval of the Reorganization Plan and eliminated that part from the Complaint limiting the action to the following (R. 12):

> 1. The liability of the two trustees for failure to disburse the income which they received as trustees in possession during the six-year period from 1925 to 1931 and whose duty it was to distribute direct to the bondholders under the terms of the Trust Indenture and which they diverted to the benefit of their house wherein they were vitally interested.
>
> 2. The liability of the two trustees for damage caused as a result of the concealment of the facts that they were in possession because of defaults from 1925 to 1931 by reason whereof the bondholders were prevented from seeking a foreclosure prior to the collapse of real estate values which would have yielded 100% on their investment and which later brought them only 8 cents on the dollar.
>
> 3. Injury resulting to the bondholders as a result of the concealment of the existing defaults during the

six-year period from May 8, 1925 to January 21, 1931, whereby they were prevented from enforcing their remedy on the personal guaranty of the principal stockholder.

4. A general accounting against the two Trustees for all funds collected and disbursed by them from the operations of the mortgaged premises from 1925 to 1934 during their tenure as Trustees in possession.

5. Loss resulting from the breach of duty of the members of the Protective Committees who served the interest of "Straus" instead of the interest of the petitioners who entrusted the bonds with them for protection.

The respondents filed their respective answers and a hearing was commenced before the chancellor on these pleadings. On the first day of the hearing the respondents obtained leave to file an Amendment to their Answer setting forth the defense of *res adjudicata* based on the Federal Court proceedings (R. 22, 23). Petitioners filed their reply urging (1) the estoppel of the respondents to interpose the plea and (2) that the 77B proceedings could under no circumstances be pleaded in bar to this action (R. 23-25). The chancellor heard the case on its merits and made no ruling on this defense. He dismissed the case for "want of equity" (R. 25). The Appellate Court affirmed his decree on the ground that the defense of *res adjudicata* was a complete bar to the action. The decision of the Appellate Court was rendered January 20, 1941 (R. 59). A petition for rehearing was filed February 5, 1941 (R. 59) which raised the point that the Appellate Court deprived the petitioners of their property without due process of law in violation of the Fifth and Fourteenth Amendments to the Federal Constitution in sustaining the defense of *res adjudicata* (see appendix). Rehearing was denied on February 5, 1941 (R. 59). The Supreme Court of Illinois denied leave to appeal on the 10th day of April, 1941.

## Questions Presented.

1. Whether petitioners were deprived of due process of law as guaranteed by the Fifth and Fourteenth Amendments to the Federal Constitution, when the Appellate Court sustained the defense of *res adjudicata* based on the 77B proceeding, notwithstanding the position of the respondents on the appeal in the Seventh Circuit that such proceedings could not be pleaded in bar to the action for the accounting.

2. Whether the petitioners were deprived of due process of law by the Appellate Court of Illinois when it sustained the defense of *res adjudicata* based on the reorganization proceeding, in which proceeding the federal jurisdiction was confined to the *res* and not to the action in *personam* against the trustees and the Committees for accounting, malfeasance and misfeasance.

3. Whether a confirmation of a reorganization plan under Section 77B may be pleaded in bar to an action for accounting and fraud against trustees and protective committees.

4. Whether the federal question was properly presented below and whether the decision below may be sustained on a non-federal question.

## Reasons for the Allowance of the Writ.

1. The decision of the Appellate Court of Illinois that an order confirming a reorganization under 77B may be pleaded in bar to an action for fraud, malfeasance, misfeasance and accounting against trustees and committees is contrary to the decisions of this court and involves matters of great importance relating to federal procedure.

2. The judgment of the State Court is challenged for due process and this court will exercise its discretionary

power to examine the course of the proceedings to ascertain whether petitioners were accorded due process.

3. The question whether adjudications in 77B, or Chapter X proceedings may be pleaded in bar to an action for accounting against trustees and committees deserves the exercise of the discretionary power of this court to issue the Writ.

PRAYER FOR RELIEF.

WHEREFORE, the above petitioners pray the allowance of a Writ of Certiorari to the Appellate Court of Illinois, First District, to the end that the decision of the Appellate Court rendered January 20, 1941 and made final by denial of leave to appeal on April 10, 1941 may be decided by this court and that the judgment be reversed.

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## BRIEF IN SUPPORT OF PETITION.

### JURISDICTION.

**Opinion Below** The opinion of the Appellate Court of Illinois for the First District was rendered January 20, 1941. The rehearing was denied February 5, 1941 and the opinion is published (308 Ill. App. page 78). The Supreme Court denied leave to appeal April 10, 1941 without any opinion.

**Jurisdiction Invoked** The statutory provision under which the jurisdiction is invoked is under Section 237b of the Judicial Code as Amended by the Act of February 13, 1925, 43 Stat. 936, 937 (28 U. S. C. A. Sec. 344b).

The Federal question was raised defensively by the plea of *res adjudicata* based on 77B proceedings (R. 23). The question was decided for the first time on review when the Appellate Court sustained this defense, which was not sustained below. The Federal question was also raised by the Petition for Rehearing.

**Authorities to Sustain Jurisdiction** The authorities believed to sustain the jurisdiction are as follows:

**(a) The Decision of the Appellate Court Made Final by the Denial of Leave to Appeal Is Subject to Review Here on Certiorari.**

*Minneapolis & St. Paul, et al.* v. *Rock*, 279 U. S. 410.

*Pennsylvania R. Co.* v. *Illinois Brick Co.*, 297 U. S. 447.

**(b) The Order Sustaining the Defense of Res Adjudicata Based on the 77B Proceedings Brings This Case Within Section 237b for Review by Certiorari.**

*Cumberland Glass Co.* v. *De Witt,* 237 U. S. 447.

*Indiana* v. *Brand,* 303 U. S. 95.

We quote the following from the *Cumberland* case *supra* (p. 449):

> "The Federal question, which is the basis of jurisdiction here, arises upon the plea of *res adjudicata* to which a demurrer was sustained in the Maryland court of original jurisdiction which judgment was affirmed by the Court of Appeals. *This presents a Federal question* because the plea of former judgment in a Federal court adjudicating a right of Federal origin, asserts a right which if denied made the case reviewable here under Sec. 709, Revised Statutes, Sec. 237, Judicial Code. *Deposit Bank* v. *Frankfort,* 191 U. S. 499."

See also Robertson & Kirkham on Jurisdiction of the Supreme Court, page 28, Section 15, Note 12, citing *Nutt* v. *Knut,* 200 U. S. 12, on the proposition that *the Federal question may be raised defensively.*

**(c) The Action of the Court in Sustaining the Defense of Res Adjudicata Based on the 77B Proceedings Raised a Federal Question As a Denial of Due Process Under the Fourteenth Amendment.**

*Simon* v. *Southern Railway,* 236 U. S. 115.

*Hansberry* v. *Lee,* 311 U. S. 32.

**(d) The Federal Question Was Properly and Timely Raised.**

No particular words are necessary to raise the Federal question and the question is sufficiently raised if it appears from the nature of the pleadings that a Federal right was before the court for a decision (*St. Louis et al.* v. *Starbird*, 243 U. S. 592, 597).

Petitioner did not anticipate that the Appellate Court would sustain the defense of *res adjudicata* as this defense was not sustained below and the question which was first presented by the decision was *timely* raised by the Petition for Rehearing (*Saunders* v. *Straus*, 244 U. S. 317; *Henderson* v. *Georgia*, 295 U. S. 441, 444). The question was also raised below *defensively* by the answer and reply (R. 23). The petition for rehearing stated (see page 31, *infra*):

> "On the question of *res adjudicata* it should be noted that *this defense was not sustained by the trial court.* A dismissal of a complaint for want of equity does not embrace a plea of *res adjudicata.* The reason why the lower court did not sustain it is apparent from the position taken by the defendants in the United States Circuit Court of Appeals where *they contended that the proceedings there can under no sense be pleaded as res adjudicata to the accounting against the trustees* (Abst. 46, 47). The entire argument in our brief (pp. 35-45) on the question of *res adjudicata was wholly overlooked* by this court. In sustaining the plea of *res adjudicata* this court deprived the plaintiffs of their property without due process of law in contravention of the Fifth and Fourteenth Amendments to the Federal Constitution. (*Cumberland Glass Co.* v. *DeWitt*, 237 U. S. 447; *Hansberry* v. *Lee*, 85 L. Ed. p. 11.)"

## STATEMENT OF THE CASE.

The facts as stated in the Petition are deemed to be sufficient for the Statement of the Case without any further statement. It is necessary, however, to give a more detailed statement of the proceedings culminating in the confirmation of the Reorganization Plan which were pleaded as *res adjudicata* to this suit.

This was the first case which presented the question to this court whether superior rights of bondholders may be given to junior interests without consideration, as part of a Reorganization Plan under Section 77B. The Federal Courts then held the view that under Section 77B, when the required number of creditors were satisfied to give up part of their security in favor of junior creditors, the courts had to approve such plans. NETTIE MEYER, the original plaintiff in this suit, who was restrained by the 77B proceedings, filed her petition in the Reorganization Proceedings attacking the good faith of the Petition and asked its dismissal and the dissolution of the restraining order. This was denied and she prosecuted an appeal to the Seventh Circuit. During the pendency of the appeal (which did not operate as a supersedeas) the District Court heard objections to the Plan filed by the other petitioners and approved the Plan with modifications, but allowed 10 per cent interest to "Straus" for its junior equity. Petitioners asked leave from the Seventh Circuit to appeal under 24b and also filed an appeal under 24a from the approval of the Plan. The Seventh Circuit held that the appeal taken by NETTIE MEYER was improperly taken under 24a and dismissed that appeal (77 Fed. (2d) 1004). It refused to grant leave to appeal from the approval of the Plan under 24b and dismissed the appeal taken under 24a on the ground that no such appeal could be taken (78 Fed. (2d) 1118). Petitioners applied for

certiorari from both orders in case Nos. 375 and 376 and on October 14, 1935 this court granted certiorari (296 U. S. 565). Among the questions presented in the Petition for Certiorari was the following:

> "May a court take away capital from the first mortgage bondholders and give it to the mortgagor and the other junior interests,"

It was pointed out in the petition (p. 32) that the plan which exchanged the bonds for stock and gave a 10% interest to "Straus" for its junior interest on a parity with the superior interest when there was no equity for the junior interest, was unfair and inequitable. This court held (297 U. S. 160) that the appeal by NETTIE MEYER was improperly taken under 24a and was properly dismissed. It further held that the appeal from the order approving the Plan could only be taken under 24b, and inasmuch as the Seventh Circuit exercised its discretion to deny the appeal, it would not review its discretionary action because "the criticisms of the Plan are not of a character to invite the exercise of the discretion." *This view was later changed* by the decision in *Case* v. *Los Angeles Products Co.* (308 U. S. page 106).

After the discharge of the Debtor, petitioners again attempted to obtain a review of the merits of the Reorganization.* They asked leave to appeal under 24b and prosecuted an appeal under 24a.** The Seventh Circuit denied leave to appeal (90 Fed. (2d) 151) and dismissed the appeal taken under 24a on the theory that it had no jurisdiction to entertain that appeal (92 Fed. (2d) 778). A petition for Writ of Certiorari was again presented to this court which was denied on January 1, 1938 (302 U. S. 767). Thereafter, on May 19, 1938, petitioners filed a Second Amendment to their Complaint (R. 11), which

* On the former appeal (297 U. S. 160) this court held that the right to appeal under 24a accrues upon an entry of an order of discharge.

** The confusion on the method of appeal was remedied by the Chandler Act.

stated, among other things, that after the filing of the original Complaint, the District Court stated in its opinion that the proceedings will not be restrained insofar as they will not interfere with the *res* which was involved in the Reorganization; that the Reorganization is now completed and under the Plan the first mortgage bondholders were given 90% of the common stock and 10% was given to the junior interest, and because of the completion of the Reorganization Proceedings, all allegations pertaining thereto are eliminated from the Complaint, and in lieu of the relief prayed in the original Complaint the petitioners asked: (a) that the trustees be required to account for all moneys received and disbursed while they were in possession; (b) that individual members of the Committees be required to account for their acts and doings and be held liable for malfeasance; (c) that the trustees be held liable for misapplication of funds derived from the income of the premises in payment to "Straus" on defaulted bonds and coupons; (d) that all defendants be required to account for all moneys received and disbursed, and (e) that the court may ascertain the value of the new securities and hold the defendants liable for the damages caused by reason of their gross negligence and fraudulent acts (R. 12-13).

Defendants filed answers to the Complaint as Amended but on the day of the trial interposed an additional defense alleging that the 77B proceedings were a complete bar to this action (R. 23), to which the petitioners replied that the action in the Federal Court could not be pleaded in bar for the reason that the 77B proceedings involved proceedings *in rem* and not proceedings *in personam*, and for the further reason that the defendants, who pleaded that the proceedings in the Federal Court are a bar to this action, have taken the opposite position in the Federal Court that the proceeding could not be pleaded in bar (R. 23-25). The Appellate Court sustained this defense (308 Ill. App., p. 78).

## ARGUMENT.

### I.

**IN SUSTAINING THE DEFENSE OF RES ADJUDICATA THE APPELLATE COURT DEPRIVED PETITIONERS OF THEIR CAUSE OF ACTION WITHOUT DUE PROCESS OF LAW IN VIOLATION OF THE FOURTEENTH AMENDMENT TO THE CONSTITUTION.**

Petitioners were not parties to the federal proceeding. This was adjudicated by the Seventh Circuit (92 Fed. (2d) 778). The Federal Court was without jurisdiction of the action *in personam* for accounting against the trustees and the Committees. In sustaining the defense of *res adjudicata* the Appellate Court deprived petitioners of their cause of action without due process of law in violation of the Fourteenth Amendment to the Federal Constitution.

**(a) A Defense of Res Adjudicata Based on a Proceeding Where the Court Had No Jurisdiction of the Parties and Subject Matter Cannot Be Sustained Without Violating the Fourteenth Amendment.**

This court has held that a defense of *res adjudicata*, based on a cause of action where the court *lacked jurisdiction* of the parties or subject matter, *is in violation of the Fourteenth Amendment* (*Hansberry* v. *Lee*, 311 U. S. 32). The defense of *res adjudicata* was not sustained below and was sustained for the *first time* on appeal. This was raised by the petition for rehearing (see appendix) which was denied (R. 59).

**(b) A Denial of Intervention Cannot Be Pleaded in Bar to an Independent Suit.**

The cause, pleaded in bar to this suit, was appealed by the petitioners (*Meyer* v. *Kenmore-Granville Hotel*, 92 Fed. (2d) 778) on the theory that they were parties to the pro-

ceedings by intervention. The Circuit Court *dismissed the appeal* on the ground that they *were not parties to the proceedings.* It said that their status was that of **"attempted intervenors"** and that the dismissal of their petition "was in effect, **a denial of the right to intervene and to participate as parties to the proceedings."** *A denial of intervention cannot be pleaded as res adjudicata to an independent* suit. (*State of Washington* v. *United States,* 87 Fed. (2d) 421, 433; *Re Decatur,* 106 Fed. (2d) 30, 32; *Credit Commutation Co.* v. *U. S.,* 177 U. S. 311.) Its statement that it looked at the merits, is not an adjudication for the reason that after it reached the conclusion *that it was without jurisdiction of the appeal it had no right to decide the merits and its statement is a nullity* (*Chicago Portrait Co.* v. *Crayon,* 217 Ill. 200; *McDonald* v. *Worth,* 367 Ill. 529, 534). Besides, it might be that in considering the merits it sustained the position taken by the *appellees* there, *that the issues involved in the independent suit were not involved there* (R. 46).

**(c) The Respondents Who Urged in the Federal Court That That Court Was Without Jurisdiction of the Subject Matter of the Accounting Were Estopped to Plead Res Adjudicata of the Action in the Federal Court.**

In the brief filed on the appeal **respondents took the position** (R. 47) that the Federal Court **had no jurisdiction in the reorganization proceeding to adjudicate the issues involved in the accounting suit.** They cited authorities on the proposition. *They could not thereafter be heard to say that the court which had no jurisdiction of the subject matter has adjudicated the questions involved in this suit.* (*Dant & Russel* v. *Halsted Lumber Co.,* 103 Fed. (2) 306, 308; *Ass. Int. Corp.* v. *Scott,* 7 C. C. A., 103 Fed. (2) 209.) It must be assumed that they were correct, *as the law conclusively*

*demonstrates that the Court in the 77B proceeding was without jurisdiction of the subject matter.* (*Re* Adolph Gobel, 80 F. (a) 849; *Re* Prudence Bonu Corporation, 75 F. (2) 262) and *the authority cited by them* (R. 41) "Utilities Power and Light Corp." (91 F. (2) 598, 602.) Being without jurisdiction of the subject matter there could be no adjudication thereof *as an adjudication without jurisdiction is completely void.* (*Toma* v. *Park Castles Bldg. Corp.*, 375 Ill. 293.) The *respondents urged on the appeal* (R. 46):

> "The **alleged liability of the mortgage trustees and the bondholders' committees is not involved in this reorganization** proceeding."

*They* said (R. 47):

> "Appellants also have their cause of action pending in the state court in which they have prayed the same relief against mortgage trustees and the committees (Ex. 19, pp. 37, 65). *In re Utilities Power and Light Corporation*, (C. C. A. 7th) June 30, 1937, C. C. H. Bankruptcy Service (page 2578) the court said:
>
> > 'Sec. 77B contemplates the reorganization of the debtor. It was not intended to provide the forum to settle collateral issues between parties who may be interested in the debtor. **Suits may be brought on unliquidated claims by the debtor after the reorganization takes place.**' "

They were *estopped* to change their position (*Stevens* v. *Stevens*, 297 Ill. 338, 345).

## II.

### THE JUDGMENT OF THE APPELLATE COURT CAN ONLY BE SUPPORTED BY THE FEDERAL QUESTION.

The statement in the opinion that the court also considered the merits may be applicable to the causes of action which the Appellate Court considered on the merits:* (a) Liability of the trustees for the deposit of

* We will show under (b) that even as to these causes the decision is untenable.

the *net income* from 1925 to 1931 with "Straus"; (b) Liability of the trustees for the failure to inform bondholders of the existing defaults in order to afford them the opportunity to exercise their legal remedies, and (c) failure to prove loss by reason of the failure of the trustees to reveal the facts to the investors. **These are the only issues discussed in the Opinion on Merits.** The Appellate Court **did not consider on the merits, the additional causes:** (d) the general accounting from the trustees for the gross receipts and disbursements from the operation of the premises from 1925 to 1934; (e) the liability of the Committee members for their betrayal of trust duties in that, instead of protecting the investors whom they assumed to protect, they protected "Straus" by taking away 10 per cent of the mortgaged premises and giving it away to "Straus" without consideration, not seeking an accounting from the trustees, and failure to protect the interest of the investors pertaining to the guaranty of the bond issue. A reading of the Opinion will disclose that the Appellate Court did not consider the merits of these claims, and the affirmance of the dismissal of the proceedings for want of equity as to these claims, can only be based on the federal question, namely, the defense of *res adjudicata.*

**(a) The Causes of Action Against the Trustees for Accounting and Against the Committees for Malfeasance Were Not Decided on the Merits But on the Federal Question.**

A decision on a non-federal question must not be *untenable.* There is no theory of law under which it may be said that beneficiaries of a trust are not entitled to an accounting from their trustees. It cannot be said that the Appellate Court sustained the dismissal of the Complaint on the ground that beneficiaries are not entitled to such

relief. *The only theory upon which its decision may be predicated, is on the federal question, that the accounting was sought in the Federal Court, was denied, and was adjudicated.* This therefore squarely presents the federal question for review.

**Suit Against Trustees For Accounting**

The original Complaint charged (R. 3) that the trustees were in possession of the mortgaged premises from May 8, 1925 to August 14, 1934 and (R. 10) that the properties were grossly mismanaged and the trustees should be directed to account. In the Amendment to the Complaint filed after the completion of the Reorganization, it was expressly prayed (R. 12) that the two trustees be required *to account for all moneys received by them and disbursed from the date of their entry into possession up to the date when the federal proceedings were commenced.* At the trial of the case the defendants admitted the request for admission of certain facts (R. 31) that the two trustees entered into possession May 8, 1925 because of the default of the mortgagor and that they managed and operated the premises. Under such a set of facts no plausible theory can be found for the decision of the Appellate Court that the beneficiaries were not entitled to the accounting, except its decision that the matter had been adjudicated. *The issue on the general accounting was therefore decided on a federal question.* Petitioners are therefore entitled to invoke the jurisdiction of this court by Writ of Certiorari.

**Suit Against Committees for Breach of Trust**

The second cause of action is the liability of the committee members for their misfeasance and malfeasance. The decision on this cause must be held to have been based on the federal question involved. The Amended Complaint sought to hold the Protective Committees liable for their unfaithful trust to the

beneficiaries in promulgating and obtaining the approval of the Plan in violation of their duties. The original Complaint charged that after "Straus" acquired the mortgaged premises in the name of SIDNEY H. KAHN, it organized Protective Committees for the two buildings, one Committee was headed by SIDNEY H. KAHN (R. 4), and the other by SAMUEL J. T. STRAUS. In soliciting the securities for deposit with the Committees, it stated that *the property was acquired by "Straus" "to protect first mortgage bondholders on both properties"* and that the Committees were formed to *protect the interests of the bondholders.* In violation of the representations and duties, the "Straus" Committees adopted a Plan which would take away from the bond owners 10 per cent of the mortgaged premises as well as control by the scheme of a Voting Trust and placed it under the control of "Straus", the equity owner (R. 6). The Amendment to the Complaint subsequent to the confirmation of the Plan eliminated the prayer for relief to prevent this Plan (R. 12), but sought relief against the Committee members for its malfeasance and misfeasance in bringing about the approval of such a Plan by the court. The evidence in the case showed that the bond issue on the Annex contained a personal guaranty, which was never enforced by the protectors (R. 38).

**The Decision on These Causes were Based on the Federal Question** The decision of the Appellate Court in discussing the merits of the case *does not discuss the merits of the claim* against the members of the Committee and the general accounting from the trustees. It must be concluded that the denial of the relief for such claims was based on the federal question, the adjudication in the 77B proceeding. In *International Steel Co.* v. *Surety Co.,* 297 U. S. 657, the court said, page 666:

> "The rule that when a decision of a state court may rest upon a non-federal ground adequate to support

it, has no application where it appears from the decision that the non-federal question was not considered."

This court may examine the opinion to see whether the court rested its decision on a non-federal question adequate to support its judgment (*Indiana* v. *Brand*, 303 U. S. 9598). There is no possible tenable theory under which the decision denying the relief against the Committee members and the trustees could be based on a non-federal question.

**The Liability Is Clear and the Denial of Relief Must Be Based on the Defense of Res Adjudicata**

The evidence was undisputed and the liability is unquestionable. It should be noted that these Protective Committees were headed by the President and Vice-President of the "underwriter" company *which acquired the equity of redemption* and that the members of the Committee had a financial interest in the underwriter and stood in an adverse position. The statement of this court in *Wood* v. *City National Bank*, 312 U. S. 262, is well apropos here. There, this court said:

> "A committee was formed by the respondent trustee to represent the first mortgage bonds in the reorganization. It was composed of five members. Two of these were officers or employees of one of the principal underwriters of the bonds. *This underwriter was heavily interested in the equity.* So far as appears, the fact was not disclosed when the committee solicited the bondholders. In any event, *the equity owner is peculiarly ill-suited to represent the mortgagee in these situations because of their historic clash of interest.* See *Case* v. *Los Angeles Lumber Products Co.*, 308 U. S. 106." (Italics ours.)

"Straus" stated in its communication (R. 25) of January 24, 1931 that the equity was acquired **"without affecting the outstanding first mortgage"**. It stated that **it acquired**

**the equity "to protect the first mortgage bondholders on both properties".** The bondholders had the right to assume that these committees in performing their trust duties *would afford due protection and not take away 10 per cent from the mortgaged premises in favor of "Straus"*, which they did by their communication of January 13, 1933 (R. 37).* It is true they gave the bondholders the opportunity to withdraw, but the bondholders were required to pay 3 per cent for this privilege. They failed to take action against the guarantor of the bond issue. They failed to obtain an accounting from the trustees for the gross income and expenses during their tenure of office from 1925 to 1934. There is no plausible theory which may be advanced why beneficiaries were not entitled to such relief from their trustees. In *Wood* v. *City National Bank, supra*, 312 U. S. 262, this court pointed out that in that case "no effort was made" to assert any liability against the "underwriters" and it said:

> "Objective scrutiny and full enforcement of an underwriter's liability requires a committee freed from that underwriter's influence."

It pointed out that:

> "The committee had as its two most active members officers of the indenture trustee. It was in substance a part of the indenture trustee's reorganization division * * * Beyond that is the fact that an indenture trustee closely affiliated with the committee shares the committee's conflict of interest."

In the instant case *such an effort was made* and the only theory to base the denial of the relief is on the federal question.

---

* The fact that the court approved the plan because the committees claimed that the required number of the depositors consented to the plan by their failure to object does not deprive the petitioners or depositors who did object from suing their trustees for their betrayal of this trust in sponsoring the plan and in obtaining its approval.

**(b) The Decision on the Merits Is Untenable and Does Not Adequately Support the Judgment.**

While it is unnecessary for the purpose of invoking the jurisdiction to discuss the decision on the merits for the reason that to at least *two causes there was no decision on the merits,* yet we will also show that *the decision on the merits on other issues is also untenable* and cannot adequately support the judgment.

**Exoneration of Trustees** The opinion holds that trustees who entered into possession *after default by the mortgagor* had the right to remain in possession *for six years* without ever disclosing such facts to the beneficiaries and to deprive them of their rights and remedies (resulting in a loss of 92 per cent of their investment) and that *such trustees are not accountable for the income received during their stewardship and are not liable for loss caused to the investors.* Such a proposition is *untenable* (*Wood* v. *City National,* 312 U. S. p. 262). The exact proposition involving a similar Trust Deed was decided adversely in *Layman* v. *Stevens,* 123 Conn. 591 (1938). There the court said:

> "In such a case as this when a substantial default of the mortgagor occurred and the trustee, in the exercise of the powers given to it by the trust instrument, undertook to pay the coupons due from its own funds, honesty and fair dealing required that the trustees within a reasonable time should take steps to notify the bondholders of the default and of its action, that the bondholders might know what was happening to their security, and that they might have an opportunity to protect their own interests by application to the court as provided in the mortgage agreement. *Marshall* v. *Ilsley Bank & Guaranty Investment Co.,* 213 Wis. 415, 250 N. W. 862, 865; *First Trust Co. of Lincoln* v. *Carlsen,* 129 Neb. 118, 123, 261 N. W. 333; *Loud* v. *Winchester,* 52 Mich. 174, 183, 17 N. W. 784; 4 Bogert, Trusts & Trustees, Sec. 961. **We hold, therefore, that**

> **the Trustee in this case committed a breach of duty in failing to give reasonable notice to the bondholders of the default of the mortgagor and the payment from the Trustee's own funds of the interest coupons.** The trustee, consequently, **is chargeable with any loss or depreciation of value in the trust property resulting from the breach of duty.** Restatement, Trusts, vol. 1, Sec. 206, Comment 3." (Emphasis supplied.)

It is curious to note that the Wisconsin decisions upon which the Supreme Court of Connecticut relied were also relied on *by the same Appellate Court in Meyers* v. *American National Bank,* 277 Ill. App. 378, involving a "Straus" case and *the same principle of law.* The instant case is much stronger than the Connecticut case for there, the concealment was only for *two* years, while here it lasted *six* years.

**Loss of 92 Per Cent Was Established** In denying the relief for the loss of 92 per cent of the investment by reason of the failure of the Trustees to advise them that they were in possession (after default) during the six-year period, the opinion states that *the court took notice of the point* that foreclosure *might have resulted prior to 1931 if the facts were made known,* but the "theory" of the case was "unusual" and "novel" because *"the depression in the value of such properties during the period from 1925 to 1931 is too well known to need comment or discussion."* In taking *judicial notice* of the "depression" it overlooked that *the depression commenced in October, 1929 and that real estate was at its height prior thereto.* If foreclosure was had prior to 1929 the bondholders would have realized *the full amount of the investment.* The defendants who advanced the interest and principal during 1925 to 1930 *must have thought that the property was worth the amount of the Bond Issue* and the court pointed out that "Straus" wound up with an investment of $400,000 in such advances. "Straus" evidently

thought the investment was safe when it was made. It is evident that a foreclosure during these years would have brought the full amount of the debt even in December, 1929. This is demonstrated from the fact that shortly after the *commencement* of the depression "Straus" saw fit *to purchase the property,* subject to the continuing lien. *Thereby the defendants established the value of the property for the full amount of the bond issue when they purchased it at the partial foreclosure on December 19, 1929, subject to the continuing lien of the remainder of the bond issue.* By their purchase of the property subject to the continuing lien *they thereby established the measure of damages* (*Loeb* v. *Stern,* 198 Ill. 371, 383). Even if the measure of the damages was improper, a dismissal would not follow but a *retrial.*

**Net Income Was Wrongfully Diverted**

The opinion justifies the deposit of the net income with "Straus" on the ground that "the Trust Deeds gave specific authority to do this." *There was no provision in the Trust Indenture authorizing the Trustees to make deposits* with S. W. Straus & Co., *after the Trustees entered into possession.* On the contrary, *the authority was limited* (R. 38) *"to apply* the residue * * * ratably, *to the persons entitled thereto without discrimination or preference." The authority to make deposits was limited to the "mortgagor"* (R. 57). Powers of a Trustee are *strictly construed* against them. (*Chicago Title and Trust Company* v. *Robin,* 261 Ill. 161.) The Trust Indenture *is the charter of the powers* of the Trustees. (*Tudor* v. *Firebaugh,* 303 Ill. App. 452; *Chicago Title & Trust Co.* v. *Chief Wash Co.,* 368 Ill. 146, 153.) If the payment was made directly to the bondholders as required under the Trust Deed (R. 38) *they would have known as early as 1925 that defaults existed* and would have been in a position to demand payment, to *sue on the guaranty* (R. 38), *or to foreclose.* The medium of the deposit with "Straus" was

used for the purpose of "lulling the bondholders into the belief" that the bond issue was in good standing (*Myers* v. *American National Bank*, 277 Ill. App. 378) and *during the six-year period when the House of Issue advanced the funds it was able to remain in business and to sell bonds under its slogan as to the safety of its securities* (R. 32). *The Trustees breached their trust when they diverted the funds for such deposit in favor of their House.* The bondholders were prevented from the enforcement of their remedies which resulted in a loss of 92 per cent of their investment.

**Maintenance of Market After Default**

The opinion states:

> "The interest was paid pursuant to the provisions of the trust deed, the purpose of which was *to prevent a default* in the bonds *which would seriously impair their market value.*" (Italics ours.)

Whose "market value" did these payments maintain? *They maintained the market for "Straus" so that it could sell its securities under its "chain of safeguards"* with the slogan "Forty-Two Years Without Loss to any Investor" (R. 32). The very thought that Trustees and their "House" *may conceal defaults* in order to "maintain a market," and the *sanction* of such deception is unthinkable. If they prevented the impairment of the "market value" of the bonds during 1925 to 1931 and they had informed the petitioners of the existing defaults they would have disposed of their bonds in such market. Conceding for the sake of argument that "Straus" had the right to advance the interest and *conceal* such facts prior to May 8, 1925, in order not to "impair" the "market value" of the bonds under the hope that the defaults might be cured *it had no right to "purchase," without the knowledge of the bondholders, after the Trustees entered into possession and to maintain a market by the concealment of such facts.*

**Adverse Interests** Samuel J. T. Straus, President of S. W. Straus & Co. and Melvin L. Straus, its Vice-President were directors and financially interested in that corporation (R. 42), and *the Trustees of the two bond issues.* Their interest to protect the bondholders was adverse to their interest as officers of S. W. Straus & Co. If the investors were notified of the default, and "Straus" failed to pay, it could not have remained in business and to hold out to the investors the "safety of the security" and that no investor has ever lost anything on that House as it held out in its pamphlets and advertisement (R. 32). *For that purpose it was necessary for the House to cash the bonds and coupons as they matured.* (*Wood* v. *Guaranty Trust,* 128 U. S. 416.) After cashing such coupons and bonds, it next became the *personal* interest of the Trustees to use the income collected thereafter to reimburse *their* House. In one instance bonds and coupons which matured in 1925 and were cashed by the House were paid out of funds deposited by the Trustees *a year later.* In many instances the funds were deposited *subsequent to three months after the default day* (R. 39).

Because of such violation of trust duties the House had a *subordinate position* on the funds advanced, under the doctrine that "this solitary rule will remove the strong temptation to trustees to act for their advantage to the detriment of the *cestui que trustent.*" The point made by the Appellate Court that the Trust Deed sanctioned such advancement is unsound as such advancement was only *authorized prior to the entry in possession by the Trustees.* The provisions are to be construed most strongly against the Trustees. It was the intention that as long as the mortgagor was in possession and there was hope to cure the defaults that such "purchase" might be made. There was no such intention *after condition broken and entry.*

The opinion said (308 Ill. App. 78, 82) that the decision of this court in *Pepper* v. *Litton,* 308 U. S. 295, was

inapplicable. There, this court pointed out that the doctrine of subordination is founded on *"the violation of rules of fair play and good conscience"* or "a breach of fiduciary standards of conduct."

Each and every principle announced by this court *was ignored in the instant case.* The purchase of the property under the junior foreclosure in the name of Sidney Kahn was admitted to have actually been for the use and benefit of S. W. Straus & Co. *wherein the two Trustees were the chief officers and directors. The Trustees could not act as trustees and at the same time own the property,* as said in *Wood* v. *City National Bank,* 312 U. S. p. 262), *"the equity owner is peculiarly ill-suited to represent the mortgagee in these situations because of their historic clash."* The scheme to own it in the name of Kahn or in the name of the corporate entity is no shield. *They have used their office of trust to help themselves through the agency of their corporate entity, to the detriment of the investors, which cannot be tolerated by a court of equity.* (*Pepper* v. *Litton, supra.*) In the *Pepper* case (which the opinion says is not in point) it was also said (p. 312):

> "No matter *how technically legal each step in that scheme may have been,* once its basic nature was uncovered *it was the duty* of the bankruptcy court *in the exercise of its equity* jurisdiction *to undo it.* Otherwise, the fiduciary duties of dominant or management stockholders would go for naught; *exploitation would become a substitute for justice; and equity would be perverted* as an instrument for approving what it was designed to thwart." (Italics ours.)

In *Wood* v. *Guarantee Trust & Safe Deposit Co.,* 128 U. S. 416, this court said:

> *"Its advancing of interest to its customers is to be attributed to a desire on its part to preserve an unimpaired market for its mortgage bonds,* rather than to a desire to confer a boon upon them by purchasing their interest coupons." (Italics ours.)

The two trustees *kept the "pathway open" from* 1915 to 1931 so that their House might advertise:

> "Every possible precaution is taken during the life of these securities to maintain them in the same attractive position in which they were when offered to the public."

and to invite the investors to "clip all coupons" and "mail them" and they would be cashed without "any unnecessary trouble" (R. 32-33).

The default occurred immediately upon the construction of the building, resulting in the *secret entry into possession by the two trustees on May 8, 1925.* Not a word was said to the investors up to January, 1931! *They were "lulled into the belief" that everything was well.* (*Myers* v. *American National Bank*, 277 Ill. App. 378.)

**Right to Relief** The last paragraph in the opinion states:

> "The holders of the comparatively small amount of these securities by much litigation have given to their bonds an unusual nuisance value."

The 19 bonds which were purchased by the plaintiffs at par from "Straus" might have taken all the money these investors had to invest. *To them the loss of 92 per cent of* their investment on these 19 bonds is of great value, and to say that because the plaintiffs are comparatively few they are not entitled to the relief is to overlook that equity is guided by justice and not by the dollar sign. This court in *Case* v. *Los Angeles Lumber Products Co.*, 308 U. S. 106, had this to say upon a similar contention:

> "In this case the fact that 92.81 per cent in amount of the bonds, 99.75 per cent of the Class A Stock and 90 per cent of the Class B Stock have approved the Plan, it is immaterial on the basic issue of its fairness as is the fact that petitioners only have $18,500 face amount of the large bond issue."

The rights of a single creditor are as sacred as the rights of the many and deserve the protection of a Court (*In re*

*Phila. & Reading Coal & Iron Co.*, 3 Cir. 105 F. (2) 357). Besides, the doctrine advanced by some of the courts for the purpose of defeating the intereset of the small investors that their interest is "a nuisance value" has been used in connection with reorganization schemes where it may be said that the small minority in opposing reorganization is trying to obtain a nuisance value. *It does not apply to this case where no attack is made to upset the reorganization Plan but to simply hold the defendants liable in damages for their breach of trust, bad faith and the loss caused to the extent of 92 per cent of the investments.* **The substantive law affords no warrant for the abridgement of the rights of the smallest investor.** (*First National Bank* v. *Flershem*, 290 U. S. 504.)

We hope that this court will give *real value* to the distressed bondholders and disregard the "nuisance value" theory by the allowance of the Writ of Certiorari.

Respectfully submitted,

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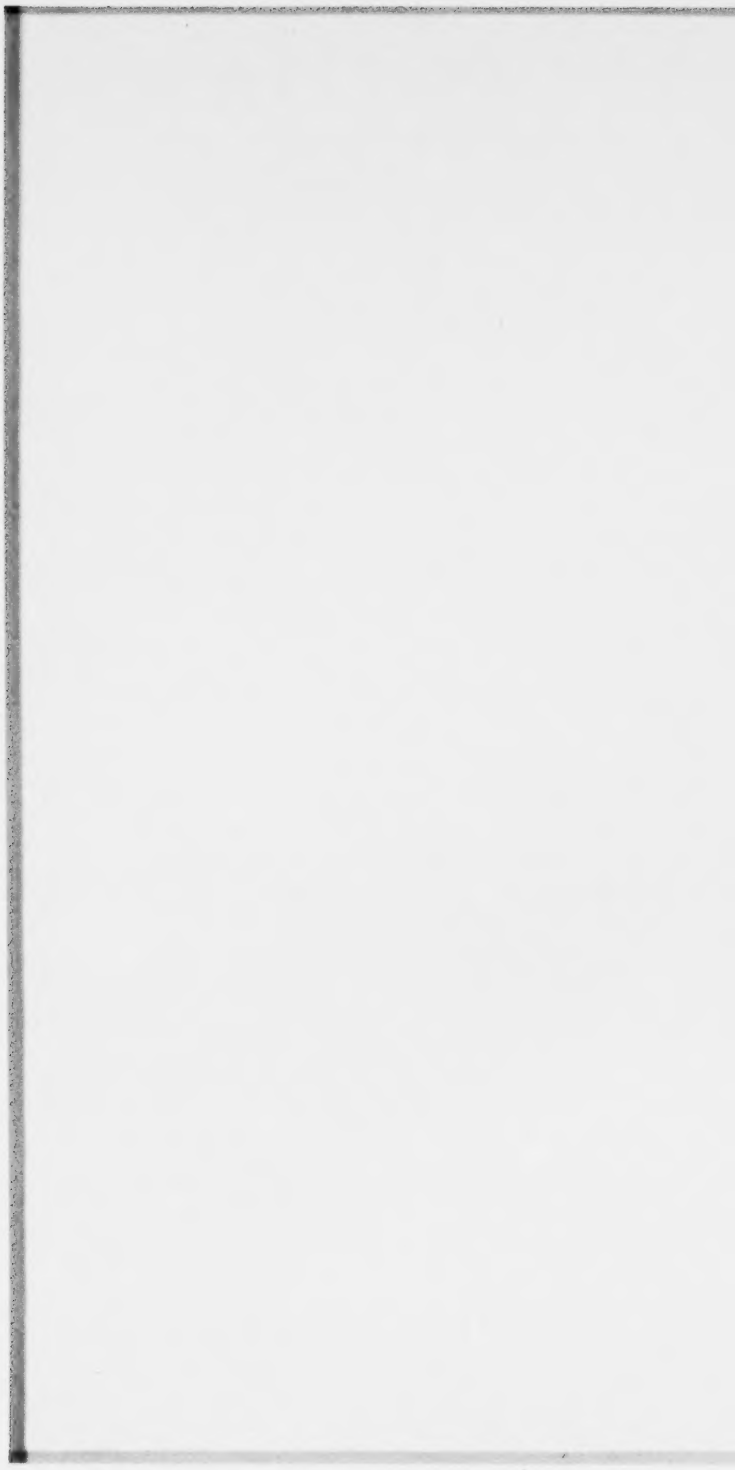

## APPENDIX.

The petition for rehearing filed in the Appellate Court on February 5, 1941 (R. 59) contained among other things the following:

"*Res Adjudicata:*

On the question of *res adjudicata* it should be noted that *this defense was not sustained by the trial court.* A dismissal of a complaint for want of equity does not embrace a plea of *res adjudicata.* The reason why the lower court did not sustain it is apparent from the position taken by the defendants in the United States Circuit Court of Appeals where *they contended that the proceedings there can under no sense be pleaded as res adjudicata to the accounting against the trustees* (Abst. 46, 47). The entire argument in our brief (pp. 35-45) on the question of *res adjudicata was wholly overlooked* by this court. In sustaining the plea of *res adjudicata* this court deprived the plaintiffs of their property without due process of law in contravention of the Fifth and Fourteenth Amendments to the Federal Constitution. (*Cumberland Glass Co.* v. *DeWitt,* 237 U. S. 447; *Hansberry* v. *Lee,* 85 L. Ed. p. 11.)"

(10)

FILED
AUG 5 1941
CHARLES ELMORE CROPLEY
CLERK

IN THE

# SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, A. D. 1941

## No. 204

NETTIE MEYER, ANNA JACOBSON, JACOB MEYERHOFF, JOSEPH MEYERHOFF, JULIUS MEYERHOFF, RAY MANN AND JOHN J. PANKIN,

*Petitioners,*

*vs.*

KENMORE-GRANVILLE HOTEL COMPANY, SAMUEL J. T. STRAUS, MELVIN L. STRAUS, M. A. ROSENTHAL, ET AL.,

*Respondents.*

## BRIEF OF RESPONDENTS IN OPPOSITION TO THE PETITION FOR WRIT OF CERTIORARI.

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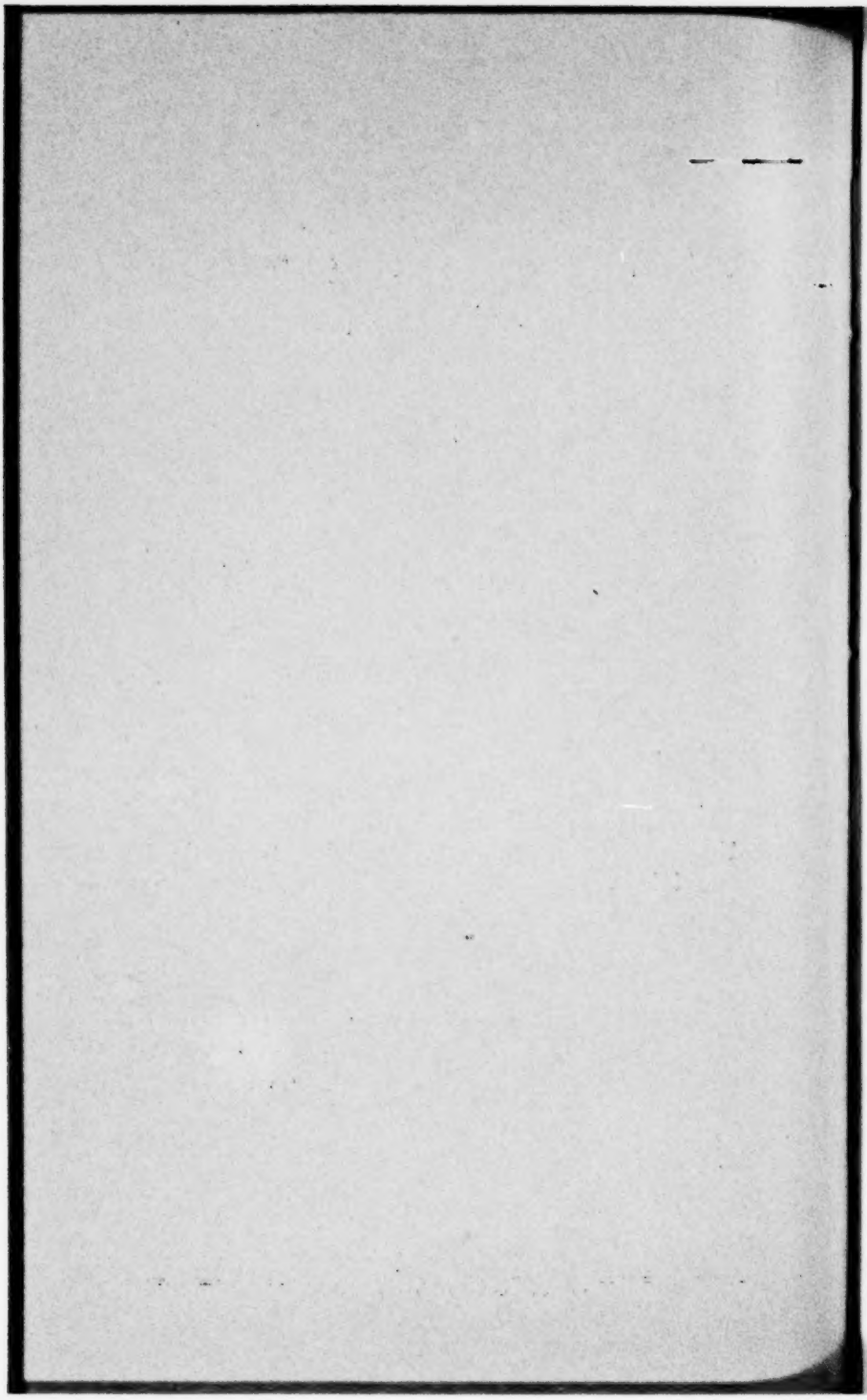

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*Respondents.*

## BRIEF OF RESPONDENTS IN OPPOSITION TO THE PETITION FOR WRIT OF CERTIORARI.

## ADDITIONAL STATEMENT OF MATTERS INVOLVED.

*To the Honorable the Chief Justice and Associate Justices of the Supreme Court of the United States:*

The plan of reorganization in the 77B proceedings on the property in question was approved May 20, 1935. On November 23, 1936, after arrangements had been made for the corporation organized under the plan to obtain a loan to pay outstanding taxes and allowed fees and expenses in the 77B proceeding, the bondholders' committees filed a

petition in the District Court of the United States asking that such a loan of $150,000 be approved, that the mortgage trustees release the two outstanding mortgages, and that a pending petition filed by Nettie Meyer, the prayers of which had been denied on February 25, 1935, be dismissed, all preparatory to consummation of the plan of reorganization and entry of a final decree discharging the debtor (R. 51).

On December 4, 1936, petitioners here presented a petition to vacate the November 23, 1935 order. It represented that while the mortgage trustees were in possession of the property since 1925 and collected the income without notifying the bondholders, they diverted such income to the payment of defaulted bonds and coupons owned by the house of issue, its officers and directors, and neglected to pay taxes, and that by such actions the trustees and the committees became personally liable for gross neglect and violation of duties and that the trustees and committees should be required to make good the loss and pay such taxes; and the petition prayed that the mortgage trustees and the committees be required to account for their acts with reference to the income of the property from 1935, the date the trustees entered into possession, until "the present time" (December 4, 1936), and if it appeared from such accounting that funds were improperly diverted they be adjudged to refund all such moneys to be used toward the payment of taxes (R. 63).

The mortgage trustees answered this petition; also, an answer was filed on behalf of the committees (R. 52). This petition and the answers were referred to a Special Master "to hear and take such evidence as may be presented by the parties upon said petition and the answers thereto, and to hear the arguments of counsel thereon, and to report to this court his conclusions of fact and law on the said petition and answers thereto" (R. 64).

The Special Master made and filed his report in which he made certain Findings of Fact. Among these were:

> "In the brief filed in support of their contentions the petitioners, and their counsel at the hearing, earnestly urged that the Special Master include in his findings of fact certain 'suggestions as to findings of fact,' the gist and purpose of which was to show malfeasance and misfeasance on the part of the Bondholders' Protective Committees and trustees under the trust deeds. I have carefully examined and considered said suggested findings of fact and do not believe them supported by the evidence submitted before me upon this hearing (R. 66). I find that the said Bondholders' Protective Committee and Trustees have acted fairly and justly and in accordance with their duties in the matters concerned which relate principally to disbursements for the payment of principal and interest of bonds, and the payment of taxes, and the relation between said Bondholders' Committees and trustees and the bondholders or beneficiaries under the said trust deeds" (R. 55).

Also among the Special Master's Findings of Fact was: that an oral stipulation was entered into, to the effect that the "moneys collected by the Trustees from the operation of the properties were deposited from time to time with the Depositary designated in the trust deeds for disbursements to holders of bonds and coupons; the holders of bonds and coupons collected their interest and principal from the Depositary upon presentation of their bonds and coupons" (R. 66).

The petitioners filed exceptions to the report of the Special Master contending, among other things, that the Special Master erred in finding that the committees and trustees acted fairly and justly in accordance with their duties; and that the master erred in recommending the

denial of the relief prayed in the petition, and that it was the duty of the Special Master to recommend the granting of the prayers of the petition, "and particularly, the relief prayed against the two Mortgage Trustees and the Bondholders' Protective Committee * * *" (R. 68).

On February 3, 1937, the District Court of the United States, after argument, entered an order in the 77B proceeding overruling each and all of the exceptions of petitioners to the report of the Special Master; confirming, approving and adopting the report of the Special Master "together with his findings, conclusions and recommendations contained therein"; and denying each and every prayer of the petition of December 4, 1936, and finally dismissing the petition (R. 68).

These are the proceedings in the 77B case which respondents set up by an amended answer on January 22, 1940, in the state court case as *res judicata* of the issues in that case (R. 23). Petitioners here on the same day filed a reply to this amendment but made no claim therein of any title, right, privilege or immunity under the Constitution of the United States.

The state court decree of February 29, 1940, recited that it was entered on the complaint, as amended, the answers, and *reply* (this being petitioners' reply to the plea of *res judicata*) and then dismissed the complaint for want of equity (R. 25).

Despite all that petitioners assert in their petition regarding the doctrine of *res judicata*, it is important to note that the Appellate Court of Illinois in its opinion in this case, *Meyer* v. *Kenmore-Granville Hotel Co.*, 308 Ill. App. 78, set forth in full in an appendix to this brief, did not decide the case solely on the ground that the decree of the District Court of the United States was *res judicata* of the issues, but only stated that it was "dis-

posed to hold that plaintiffs are precluded." The Appellate Court also said, p. 82:

> "Plaintiffs in the original suit in the State court set up the same matters which were considered upon this reference in the United States court, and upon the conclusion of the litigation in the federal courts defendants set up in the State court the federal judgment as *res adjudicata* of the issues. The issues and the parties were identical and having been once determined by a court of competent jurisdiction it would seem the maxim that there must be an end to litigation should be applied. *Stoll* v. *Gottlieb*, 305 U. S. 165. We are disposed to hold that plaintiffs are precluded. *However, we have given consideration to the appeal on its merits.*" (Italics ours.)

The court further said:

> "*The federal courts have decided their charges against these trustee to be without merit and a careful consideration of the record leads us to the same conclusion. The judgment will be affirmed.*" (Italics ours.)

## SUMMARY OF ARGUMENT.

### I.

Statement in petition for rehearing before Appellate Court that the court in sustaining the plea of *res judicata* deprived plaintiffs of their property without due process of law under the Fifth and Fourteenth Amendments does not specially set up any title, right, privilege or immunity under Constitution of the United States. Such statement is not specific or broad enough to include contention that federal court did not have jurisdiction of subject matter or parties in December 4, 1936 petition filed by petitioners for accounting by trustees and committees.

### II.

The bankruptcy court had jurisdiction of the subject matter of petitioners' petition of December 4, 1936 which sought to compel mortgage trustees to account for and pay moneys over to the estate. It had jurisdiction of the petitioners who invoked it by presenting the petition; and of the mortgage trustees and the committees because they submitted and consented to jurisdiction.

### III.

A claim of right, title, privilege or immunity under the Constitution comes too late when made in a petition for rehearing unless the action of the highest court of the state complained of could not have been anticipated.

## IV.

The decision of the Appellate Court complained of should have been anticipated because (a) the trial court sustained the plea of *res judicata*; (b) the decree of the trial court decided that it was made upon the amended complaint, the answer including the plea of *res judicata,* and upon the *reply* of petitioners, thereby giving petitioners full notice that it had passed upon the plea of *res judicata*; and (c) petitioners devoted ten pages of their brief in the Appellate Court to *res judicata* but claimed no right, title, privilege or immunity under the Constitution.

## V.

Opinion of Appellate Court shows that it carefully examined the record and concluded that contentions of petitioners were without merit; and therefore it agreed with the opinion of the District Court and, accordingly, affirmed the judgment.

## ARGUMENT.

### I.

**No right, title, privilege or immunity was specially claimed under the Constitution, a treaty or a statute of the United States.**

The only claim made, was in the petition for rehearing to the Appellate Court of Illinois, 308 Ill. App. 78 (which does not appear in the record, only in the petition), that: "In sustaining the plea of *res adjudicata* this court deprived the plaintiffs of their property without due process of law in contravention of the Fifth and Fourteenth Amendments to the Federal Constitution" (Petition 31). Of course, the Fifth Amendment is not involved. This claim does not raise a Federal question. A decision of a state court sustaining a plea of *res judicata* does not present a Federal question. *City and County of San Francisco* v. *Itsell*, 133 U. S. 65, 33 L. ed. 570; *Adams & Co.* v. *Board of Liquidation of the State of Louisiana*, 144 U. S. 651, 36 L. ed. 578. In the *Itsell* case the state court had decided the issue whether a former judgment rendered against plaintiff in error was a bar to the action. This court, by Mr. Justice Gray, said: "That was a question of general law only, in no wise depending upon the Constitution, treaties or statutes of the United States. *Chouteau* v. *Gibson*, 111 U. S. 200." In the *Adams* case this court held that a decision of a state court, as to plea of prior adjudication, does not present any Federal question. This court said: "Whether or not the adjudication upon the first bonds of the same series could be pleaded as an estoppel to

the proceeding for the refundability of other bonds of the same series, is not a Federal question."

Petitioners cite *Cumberland Glass Mfg. Co.* v. *DeWitt*, 237 U. S. 447, 59 L. ed. 1043, and *Hansberry* v. *Lee*, 311 U. S. 32, 85 L. ed. 11, in support of their contention that sustaining the plea of *res judicata* deprived plaintiffs of their property without due process of law. The *Cumberland* case does not hold that sustaining a plea of *res judicata* raises a Federal question; but does hold that the sustaining of a demurrer to a plea of *res judicata* based upon a judgment of a federal court adjudicating a right of federal origin, presents a Federal question, "because the plea of former judgment in a Federal court adjudicating a right of Federal origin asserts a right which, *if denied*, made the case reviewable here under § 709, Revised Statutes, § 237 Judicial Code." No Federal question arises with respect of a state court order that *recognizes* a right established by a federal court order. The Federal question involved in the *Hansberry* case was not sustaining a plea of *res judicata*, but was the fact that in the prior adjudication the court did not have jurisdiction of the parties.

The question remains whether this pretended claim is broad enough to include the contention, first made in the petition for *certiorari* in this court, that the District Court of the United States did not have jurisdiction of the parties or the subject matter in its order of February 3, 1937.

Petitioners' claim as set up is too general to raise such a Federal question. There is not even color of a Federal question. *Hamblin* v. *Western Land Co.*, 147 U. S. 531, 37 L. ed. 267. The Federal right must be specially set up. This is particularly true in view of the fact that petitioners never questioned the jurisdiction of the District Court of the United States over the parties to or the subject matter of their petition of December 4, 1936, before the Special Master, in the District Court, in the appeal to the United

States Circuit Court of Appeals, *Meyer* v. *Kenmore-Granville Hotel Co.*, 92 F. (2d) 778, nor in the petition for certiorari denied in this court, *Meyer* v. *Kenmore-Granville Company*, 302 U. S. 767; nor in the Superior Court of Cook County, nor in their appeal from the decision of that court to the Appellate Court of Illinois, *Meyer* v. *Kenmore-Granville Hotel Co.*, 308 Ill. App. 78. Their pretended claim of title, right, privilege or immunity as set forth in their petition for rehearing in the Appellate Court of Illinois gave that court no inkling that the petitioners were attacking the jurisdiction of the District Court to enter its order of February 3, 1937.

Such claim was first made in their petition for *certiorari* to this court. On page 7, that petition states that "the federal jurisdiction was confined to the *res* and not to the action *in personam* against the trustees and the committees for accounting, malfeasance and misfeasance." On page 15, their petition states: "The federal court was without jurisdiction of the action *in personam* for accounting against the trustees and the committees." This is all there is to be found in the petition for *certiorari* or in the record to establish petitioners' contention made at this late hour that the District Court lacked jurisdiction in entering the February 3, 1937 order and we submit it is insufficient; and further that no substantial Federal question is raised on this record.

## II.

**The bankruptcy court had jurisdiction of the subject matter of petitioners' petition of December 4, 1936, and of the parties thereto.**

Bankruptcy courts have jurisdiction to recover assets or to enforce rights belonging to the estate if the defendants or adverse claimants consent thereto. *Harris* v. *First Na-*

*tional Bank,* 216 U. S. 382; 54 L. ed. 528. When there is such *consent* to jurisdiction in a bankruptcy court, as there was here, that jurisdiction will cover determination of all claims of the parties involved. *In re Blake,* 150 Fed. 279. In this case petitioners sought to compel the mortgage trustees to account for and pay moneys over to the estate. They did this by presenting a petition in which they invoked the jurisdiction of the District Court. These trustees and committees submitted to the jurisdiction of the bankruptcy court and answered the petition. Petitioners' present claim of lack of jurisdiction in the District Court in the premises is unsubstantial and trivial. It was not even argued in their brief.

It is argued, however, that respondents took a position in their brief in the Circuit Court of Appeals inconsistent with their position in presenting the District Court order as *res judicata* of the issues in the state court case; and that, therefore, they were estopped to plead *res judicata.* To support this contention petitioners lifted a few paragraphs of respondent's brief in the Circuit Court of Appeals from their context and inserted them in the record (R. 45). We do not believe them susceptible of the interpretation placed on them by petitioners. However, whether respondents were or were not estopped to plead *res judicata* was a general question of law and not a Federal question. In *Beals* v. *Cone,* 188 U. S. 184, 47 L. ed. 435, this court said:

> "The estoppel was not one of record, but *in pais,* arising, as contended, from contradictory statements made by one of the defendants at a different time and place. Whether such statements worked an estoppel depends, not upon the Constitution or any law of Congress, involves no Federal question, but is determined by rules of general law."

## III.

### The claim of right, title, privilege or immunity under the Constitution was made too late.

The pretended claim was made after the final judgment of the state court of last resort. It could and should have been made in the trial court. This court has held it is elementary that a mere assertion in a state court of a right under the Constitution of the United States in a petition for rehearing affords no ground for invoking the jurisdiction of this court unless the court below, in dealing with the petition for rehearing, considers and passes upon the Federal ground therein relied upon. *Bowe* v. *Scott*, 233 U. S. 658, 58 L. ed. 1141. The Appellate Court of Illinois did not consider and pass upon the Federal ground presented and relied upon by petitioners in their petition for rehearing to that court. It is well settled that the Federal right must have been set up and adjudicated against the claimant by the judgment of the state court before he may bring the case to this court. *Cleveland & P. R. Co.* v. *Cleveland*, 235 U. S. 50, 59 L. ed. 127. It was said in *Spies* v. *Illinois*, 123 U. S. 131, 31 L. ed. 80 that if the right was not claimed in the proper court below, the judgment of the highest court of the state is conclusive, so far as the right of review is concerned. A long line of decisions of this court is to the effect that it is too late to raise a Federal question for the first time in a petition for rehearing after the final judgment of the highest state court, unless the state court actually entertains the petition and decides the Federal question and this appears from the record. *Susquehanna Boom Co.* v. *West Branch Boom Co.*, 110 U. S. 57, 28 L. ed. 69; *Mutual Life Ins. Co.* v. *McGrew*, 188 U. S. 291, 47 L. ed. 480; *Kentucky Union Co.* v. *Kentucky*, 219 U. S. 140, 55 L. ed. 173.

The record is devoid of anything showing that a Federal question was raised and decided, so as to confer jurisdiction on the Federal Supreme Court. *Harding* v. *Illinois*, 196 U. S. 78, 49 L. ed. 394. An examination of the opinion (Appendix, this brief) rendered by the Illinois Appellate Court discloses clearly and definitely that no Federal question was decided.

## IV.

**Petitioners' contention that their claim of title, privilege and immunity set forth in the petition for rehearing to the Appellate Court of Illinois is timely, because the decision of the Appellate Court on res judicata was unanticipated, is without merit.**

Petitioners refer to *Saunders* v. *Shaw*, 244 U. S. 317, 61 L. ed. 1163, and *Herndon* v. *Georgia*, 295 U. S. 441, 79 L. ed. 1530, to support this contention. In those cases it was held that when the act complained of is the act of the state supreme court done unexpectedly at the end of the proceedings, when plaintiff in error no longer has any right to add to the record, it would leave a serious gap in the remedy for infraction of constitutional rights if the party aggrieved in such a way could not come to this court; but this court said in the *Herndon* case:

> "The whole point, therefore, is whether the ruling here assailed should have been anticipated."

We think there is no doubt that this ruling "should have been anticipated." It should have been anticipated in the trial court where petitioners made reply to the plea of *res judicata* set up in the amendment to respondents' answer in that case; but in which reply no claim of title, right, privilege or immunity under the Constitution was made.

Petitioners assume that because the decree of the trial court was a dismissal for want of equity, it did not decide the *res judicata* question. There is no room for this assumption. The proper order on sustaining a plea in chancery is dismissal of the bill. In *U. S.* v. *California & Oregon Land Co.*, 148 U. S. 31, 37 L. ed. 354, this court discusses the nature and function of pleas in equity and quotes from *Farley* v. *Kittson*, 120 U. S. 303, 30 L. ed. 684, as follows:

> "* * * The plaintiff may either set down the plea for argument, or file a replication to it. If he sets down the plea for argument, he thereby admits the truth of all the facts stated in the plea, and merely denies their sufficiency in point of law to prevent his recovery. If, on the other hand, he replies to the plea, joining issue upon the facts averred in it, and so puts the defendant to the trouble and expense of proving his plea, he thereby, according to the English chancery practice, admits that, if the particular facts stated in the plea are true, they are sufficient in law to bar his recovery; and if they are proved to be true, the bill must be dismissed, without reference to the equity arising from any other facts stated in the bill. Mitford, Ch. Pl. 302, 303; Story, Eq. Pl. § 697. That practice in this particular has been twice recognized by this court. *Hughes* v. *Blake*, 19 U. S. 6 Wheat, 453, 472; *Rhode Island* v. *Massachusetts*, 39 U. S. 14 Pet. 210, 257."

The case of *Perry* v. *United States School and Furniture Co.*, 135 Ill. App. 1, involved pleas in chancery. After general replication to each plea, the order in sustaining the pleas was a dismissal for want of equity.

Presumably the Appellate Court of Illinois was of the opinion that the trial court had sustained the plea of *res judicata* and that it was reviewing this decision. This is true because the Appellate Court of Illinois has only ap-

pellate jurisdiction. Smith-Hurd Ann. St. Ch. 37 § 32, provides that appellate courts "shall exercise appellate jurisdiction only."

Furthermore, the decree of the trial court recites that it is entered upon the complaint, as amended, the answer and the *reply*. The *reply*, filed by petitioners related solely to the plea of *res judicata*. Accordingly, petitioners had full notice that the order of the trial court made disposition of the plea of *res judicata*.

However, indisputable evidence that petitioners did anticipate action by the Appellate Court of Illinois on the plea of *res judicata* is the statement of petitioners in their petition for rehearing that: "The entire argument in our brief (pp. 35-45) on the question of *res adjudicata* was wholly overlooked by this court," referring to the Appellate Court of Illinois. The court will note that petitioners devoted 10 pages of their brief to the "unanticipated" question of *res judicata;* but not one word in respect of any claim of right, title, interest or immunity under the Constitution of the United States.

## V.

### The entire decision of the Appellate Court of Illinois was on non-federal questions.

Not a word of the opinion of the Appellate Court is devoted to a Federal question.

The court first discusses the proceedings in the 77B case, set forth in the plea of *res judicata*, and concludes: "We are disposed to hold that plaintiffs are precluded." This is not a decision of a Federal question. As we have already shown, a state court decision on a question of *res judicata* is a decision of general law and not of a Federal question.

However, the next sentence of the Appellate Court settles the whole matter. It is: "However, we have given consideration to the appeal on its merits." The court then demonstrates in three places on page 83 of the opinion that it had examined the record; and it is obvious the court made its decision from its examination of the record and did not base its decision solely on the bar of the 77B order. The court said:

> "* * * The federal court has decided their charges against these trustees to be without merit and a careful consideration of the record leads us to the same conclusion. The judgment will be affirmed."

This last sentence shows that the judgment was affirmed, not on the ground that petitioners were barred by the prior Federal Court adjudication, but on the ground that the Appellate Court of Illinois, after a careful consideration of the record, came to the same conclusion arrived at by the Federal Court. We submit the petition for certiorari should be denied.

CLAUDE A. ROTH,
*Attorney for Respondents.*

HARRY E. SMOOT,
*Of Counsel.*

# APPENDIX.

**Nettie Meyer, et al., Appellants v. Kenmore-Granville Hotel Company, et al., Samuel J. T. Straus, et al., Appellees.**

**Gen. No. 41220.**

Mr. Justice Matchett delivered the opinion of the court.

The plaintiffs own 19 bonds of issues amounting to $1,000,000 each, secured by trust deeds conveying the Sovereign Hotel and the "Annex" to it. Default was made. On May 8, 1925, the trustees took possession and operated the hotels as a unit until August 14, 1934, when a tax receiver was appointed for both premises.

February 4, 1935, the debtors filed a petition in the United States District Court under §77B of the amended Bankruptcy Act (11 U. S. C. A., §207) for reorganization. February 8, this suit for an accounting against the trustees and others was filed. Plaintiff, Nettie Meyer, on February 25, 1935, filed a petition in the United States District Court to dismiss the proceedings because of bad faith and want of jurisdiction. The court reserved ruling until after the plan of reorganization should be submitted but directed notice of proceedings to be given to her counsel. When the plan was filed plaintiffs filed objections and submitted modifications. Nettie Meyer (not wishing to waive her claim of bad faith) did not join in the proposed modifications. The plan as modified was approved May 26, 1935. Nettie Meyer appealed from the order denying her motion to dismiss and also from the order approving the plan as modified. Her appeals were dismissed by the

United States Circuit Court of Appeals. Certiorari was allowed by the Supreme Court of the United States. Upon review the court held the appeals were properly dismissed because such appeals were only by leave, which she had not obtained. (*Meyer* v. *Kenmore Granville Hotel Co.*, 297 U. S. 160.)

November 23, 1936, the United States District Court entered an order directing the release of the two trust deed indentures and authorizing a new mortgage of $150,000, and dismissed the petition of Nettie Meyer.

December 4, 1936, plaintiffs filed their petition to vacate the order of November 23, setting up that it was entered in the absence of counsel and that the trustees (defendants here) had not been required to account for their management of the premises while in possession. Answers were filed and the petition sent to a referee, who reported recommending that the prayer of the petition be denied. Exceptions were filed by plaintiffs which were overruled by the court and the report approved February 25, 1937.

Plaintiffs undertook to secure a review of this order without leave and for this reason the appeal from the order was dismissed. (*In re Kenmore-Granville Hotel Co.*, 92 F. (2d) 778; *Meyer* v. *Kenmore-Granville Hotel Co.*, *Id.*) The court of appeals said "appellants" could not reopen the issues concerning which their appeals were dismissed, citing *In Re Trust Co. No. 2988 of Foreman Trust & Savings Bank*, 85 F. (2d) 942. The opinion states:

"The report of the referee indicates a very careful consideration of the oral testimony, stipulation of facts, briefs and argument of counsel. On the basis of this study he concluded that the parties had adequate notice of the hearing of November 23, and opportunity to object at that time if they so desired. He also found that the issues sought to be raised by the petition of December 4, were

substantially identical with those sought to be raised by appellant Meyer in her petition of February 25, 1935, the prayer of which was denied on March 20, 1935. They are also similar to those raised by the objections filed by the other appellants to certain claims against the debtor and to the plan of reorganization, which objections were overruled by the court May 20, 1935. The referee therefore states, 'Both . . . Meyer . . . and her co-petitioners . . . had ample opportunity . . . to raise each and every issue which is now sought to be raised in the petition now pending as filed by said petitioners. The petition now pending is merely an attempt, in a roundabout, subsequent, and extraordinary manner, to obtain a review of matters heretofore presented to and determined by a Judge of this Court, without pursuing the usual method of writs of appeal and certiorari to upper courts from the actual orders and proceedings of which complaint is made.' ''

Plaintiffs in the original suit in the State court set up the same matters which were considered upon this reference in the United States court, and upon the conclusion of the litigation in the federal courts defendants set up in the State court the federal judgment as *res adjudicata* of the issues. The issues and the parties were identical and having been once determined by a court of competent jurisdiction it would seem the maxim that there must be an end to litigation should be applied. *Stoll* v. *Gottlieb*, 305 U. S. 165. We are disposed to hold that plaintiffs are precluded. However, we have given consideration to the appeal on its merits.

Plaintiffs allege the trustees while in possession of the property deposited the income from the premises with S. W. Straus & Company. These bonds were what were known as "Straus bonds." The trustees and most of the bondholders' committee were interested in S. W. Straus & Company. It is urged the trustees ought not to have used

S. W. Straus & Company as a depositary. The bonds and coupons were payable at the office of S. W. Straus & Company. There was nothing in the trust deed to prevent the trustees from so depositing the funds, although in view of the entire situation rules applicable to fiduciaries generally would apply. *Pepper* v. *Litton,* 308 U. S. 295, 60 Sup. Ct. 238, cited, is not applicable.

The complaint charged the trustees acted wrongfully in that S. W. Straus & Company were allowed to reimburse themselves out of funds deposited with them on account of moneys which it advanced from its own funds in order to meet the payments of coupons and principals at maturity. Defendants insist that there is no proof this was done. Plaintiffs insist it is admitted by the pleadings (also proved) and that it is contrary to law. *Coffey* v. *Lawman,* 99 F. (2d) 245. That case holds such a payment by a volunteer is not a purchase of the bond or coupon paid and that its effect is to subordinate the bonds and coupons thus paid to the rest of the issue. This case is, however, distinguishable from that and similar cases cited by plaintiffs to this point, in that here the trust deed gave specific authority to do this. Moreover, the record shows that notwithstanding this provision in the trust deed, S. W. Straus & Company voluntarily subordinated almost $400,000 par value of bonds and coupons which it had paid in reliance upon this provision of the trust deed. We search this record in vain for evidence from which it can be inferred that these plaintiffs have been injured in any way on account of this. We say this not unaware of the dangers inherent in this practice.

Plaintiffs further seek to have the trustees held liable on the ground of gross negligence and fraud. First, it is said, they permitted a second mortgage on these premises to be foreclosed and title to be obtained through a master's deed by one of the officials of S. W. Straus & Company.

The holders of the first mortgage were not made parties. In what respect plaintiffs were injured or their securities depreciated by this foreclosure the record does not disclose and we are unable to see.

Secondly, plaintiffs present in the State as in the federal court the novel contention that the payment of interest from 1925 to 1931 by the trustees without disclosing default of the mortgagors to the holders of the bonds was fraudulent and thereby plaintiffs lost 90 per cent of their investments, for which defendants are liable. The interest was paid pursuant to the provisions of the trust deed, the purpose of which was to prevent a default in the bonds which would seriously impair their market value. The evidence is devoid of any proof tending to show that the loss which plaintiffs have sustained was in any way the result of these payments. The theory that the payment of a part of a given security may cause the loss of the rest of it is unusual and novel. Of course, if these payments had not been made and the issue allowed to go into default a foreclosure might have resulted. In that case plaintiffs might have appropriated the property to the payment of their debt. The depreciation in the value of such properties during the period of time from 1925 to 1931 is too well known to need comment or discussion. The books are full of cases showing that important fact to the sorrow of many investors.

The holders of this comparatively small amount of these securities by much litigation have given to their bonds an unusual nuisance value. The federal courts have decided their charges against these trustees to be without merit and a careful consideration of the record leads us to the same conclusion. The judgment will be affirmed.

*Judgment affirmed.*

O'Connor, P. J., and McSurely, J., concur.

IN THE

# Supreme Court of the United States

OCTOBER TERM, A. D. 1941.

## No. 204

NETTIE MEYER, ANNA JACOBSON, JACOB MEYERHOFF, JOSEPH MEYERHOFF, JULIUS MEYERHOFF, RAY MANN AND JOHN J. PANKIN,

*Petitioners,*

*vs.*

KENMORE-GRANVILLE HOTEL COMPANY, SAMUEL J. T. STRAUS, MELVIN L. STRAUS, M. A. ROSENTHAL ET AL.,

*Respondents.*

ON PETITION FOR WRIT OF CERTIORARI TO THE APPELLATE COURT OF ILLINOIS, FIRST DISTRICT.

## PETITIONER'S REPLY BRIEF.

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Chicago, Illinois.

THE GUNTHORP-WARREN PRINTING COMPANY, 810 WEST JACKSON, CHICAGO

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1941.

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NETTIE MEYER, ANNA JACOBSON, JACOB MEYERHOFF, JOSEPH MEYERHOFF, JULIUS MEYERHOFF, RAY MANN AND JOHN J. PANKIN,

*Petitioners,*

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*Respondents.*

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ON PETITION FOR WRIT OF CERTIORARI TO THE APPELLATE COURT OF ILLINOIS, FIRST DISTRICT.

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## PETITIONER'S REPLY.

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### STATEMENT.

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Respondents made no attempt to answer Point II of the petition (pp. 17-30) showing that notwithstanding the statement in the opinion that the court did not rest its decision on the defense of *res adjudicata* and considered the merits, the decision can only rest on the federal question. The answer of the respondents is limited to the points: (1) that no right was specially claimed under a

federal statute; (2) that the defense of *res adjudicata* was properly sustained as the Bankruptcy Court acquired jurisdiction of the subject matter and of the parties by consent; and (3) that the federal question was not timely raised. We will, therefore, reply to these points.

**RIGHT CLAIMED UNDER FEDERAL STATUTE.**

The claim of the right under a federal statute was fully discussed in the petition (pp. 10-11). We cited the *Cumberland* case (237 U. S. 447) on the point that a defense of *res adjudicata* based on a judgment of a federal court adjudicating a right of *federal origin* raises a federal question for review. In answer thereto, respondents say (p. 9) that this is true when the plea is *denied* and not when the plea is *sustained* as in the instant case. Respondents would be correct if this were an appeal under 237(a). The requisite there is the denial of the right. This review, however, is sought by certiorari under 237(b) and *whether the defense was denied or sustained is of no importance under that section* (Robertson and Kirkham on Jurisdiction of Supreme Court, § 55 and § 58, pp. 100, 102-103). It is also of no great importance how the federal question was raised in view of the fact that the Appellate Court *decided the federal question* (*Hill* v. *Smith*, 260 U. S. 592; *Whitefield* v. *Ohio*, 297 U. S. 431.) The defense of *res adjudicata* was based on the amendment to the Bankruptcy Act under § 77B. The adjudication, therefore, was *on a judgment of a federal origin* and this presents a federal question for review under 237(b) (*St. Louis, et al.* v. *Starrbird*, 243 U. S. 592).

**JURISDICTION OF BANKRUPTCY COURT.**

Respondents contend that the court properly sustained the defense of *res adjudicata* because the Bankruptcy Court acquired jurisdiction of the subject matter and of the parties by consent. If the issues were presented to the Federal Court

and decided by it there would be some merit to the argument. However, *the respondents urged on the appeal from the federal decision that these issues were not involved in the suit and that these issues are only involved in the independent suit pending in this cause* (R. 45-46). The Federal Court did not decide this issue and simply *denied the intervention* (92 F. (2) 778). We have cited authorities in the petition (p. 15) on the point that *denial of intervention may not be pleaded as a bar to an independent suit.*

**THE FEDERAL QUESTION WAS TIMELY RAISED.** This question was fully discussed in the petition (p. 11). Respondents overlooked that besides the federal question which was raised by the petition for rehearing on the point that the sustaining of the defense was in violation of the Fifth Amendment, the federal question was raised *defensively* by the respondents and *actually decided* by the Appellate Court in its opinion. We have also shown that the *additional federal question* based on the Fifth Amendment was timely filed in view of the decision of the Appellate Court (*Home Insurance Co.* v. *Dick*, 281 U. S. 397, 407).

**THE REPLY TO THE DEFENSE OF RES ADJUDICATA DID NOT ADMIT THE SUFFICIENCY THEREOF.** Respondents' contention (p. 14) that petitioners' reply to the defense of *res adjudicata* admitted the sufficiency is based on the Illinois law which existed *prior* to the adoption of the Civil Practice Act and they overlooked that the Civil Practice Act in Illinois abolished the former rule (See § 155, § 156 of the Civil Practice Act and the historical data in connection with these sections, *Smith-Hurd Illinois Annotated Statutes*, Chapter 110, page 143). We quote the following from the headline "Histrical Practice Notes":

> "Under the former equity practice a party by replying to a plea waived all objections to its sufficiency

and admitted the plea to be good in law and raised an issue on facts only. This section, together with the provision of § 155, *ante*, to the effect that there should not be any distinctions respecting the manner of pleadings between actions at law and suits in equity appears to change the former technical equity rule respecting a reply to a plea."

**NON-FEDERAL QUESTION WAS UNTENABLE.** This question was fully discussed in the petition (pp. 18-30) and the only answer in respondents' brief is that the court stated that it considered the merits. This alone, of course, is of no importance in view of the showing that this position was untenable.

For the foregoing reasons we urge the issuance of the writ.

Respectfully submitted,

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